

Members

Rep. John Day, Chairperson
Rep. Carolene Mays
Rep. Dan Stevenson
Rep. Randy Borrer
Rep. Jeff Espich
Rep. Eric Gutwein
Sen. Thomas Weatherwax, Vice-Chairperson
Sen. David Ford
Sen. Thomas Wyss
Sen. John Broden
Sen. Nancy Dembowski
Sen. Vi Simpson



INTERIM STUDY COMMITTEE ON CORPORATE TAXATION

Legislative Services Agency
200 West Washington Street, Suite 301
Indianapolis, Indiana 46204-2789
Tel: (317) 233-0696 Fax: (317) 232-2554

LSA Staff:

Diane Powers, Fiscal Analyst for the Committee
Jim Landers, Fiscal Analyst for the Committee
George Angelone, Attorney for the Committee

Authority: P.L. 81-2004

MEETING MINUTES¹

Meeting Date: August 24, 2004
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington St.,
Room 404
Meeting City: Indianapolis, Indiana
Meeting Number: 2

Members Present: Rep. John Day, Chairperson; Rep. Dan Stevenson; Rep. Randy Borrer; Rep. Jeff Espich; Rep. Eric Gutwein; Sen. Thomas Weatherwax, Vice-Chairperson; Sen. David Ford; Sen. John Broden; Sen. Nancy Dembowski; Sen. Vi Simpson.

Members Absent: Rep. Carolene Mays; Sen. Thomas Wyss.

I. Call to Order

Representative John Day, Chairman, called the meeting to order at 10:11 A.M.

II. Ohio experience with Passive Investment Companies (PIC's)

The Chair introduced Mr. Jeffrey Sherman, Legal Counsel for the Ohio Department of Taxation, to begin the testimony on Ohio's approach to PIC's.

Mr. Sherman discussed the history and process behind Ohio's framework for addressing the use of PIC's as tax shelters for corporations. He explained the processes that corporations used to avoid paying tax in Ohio. Mr. Sherman gave the Committee some examples describing how the use of these PIC's could reduce the companies' Ohio tax liability. He then described the use of trademarks and intangible property. Mr. Sherman also commented that Ohio's legislation was an attempt to close a loophole, but not an attempt to make the whole tax system

¹ Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.ai.org/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

unfair. Ohio's law limited the add back so that it would be no worse than if the entity had filed a combined report in order to ensure fundamental fairness. Mr. Sherman stated that the disallowance of these expenses has increase Ohio revenue by approximately \$50 M annually with an additional \$10 M which comes in under audit.

The Committee members discussed and questioned Mr. Sherman on the following topics:

- Combined reporting requirements
- Trademark royalties, and loans back to Corporations
- Affect of the legislation on Ohio companies
- Distinguishing legitimate loans from abusive loans
- Safe-harbors or Good faith exceptions
- Adverse reactions
- Affect on small business
- Competitive disadvantages that small businesses may face now.

III. Other state approaches to PIC's

Senator Thomas Weatherwax, Vice-Chairman, then introduced Mr. Joe Crosby, Legislative Director of the Council on State Taxation (COST) to testify on the other approaches states have taken in regulating PIC's.

Mr. Crosby distributed and discussed two handouts with the Committee. One was entitled "Total State and Local Business Taxes", and the other handout was the COST's critique of a study done by the Multistate Tax Commission (MTC) that was distributed at the Committee's first meeting. (Exhibits 1 & 2)

The Committee discussed the following issues with Mr. Crosby:

- COST's criticism of the MTC's report methodology
- COST's membership and funding structure
- PIC's and the definition of business purpose and economic substance
- problems specific to regulated industries (such as regulated utilities)
- COST's recommendations for a model statute regulating PIC's
- different approaches to PIC regulation
- PIC monitoring, auditing, reporting requirements, add backs

III. PIC issues in Indiana

The Chairman next recognized Mr. Mark Richards, Partner at Ice Miller, to speak to the Committee about PIC issues in Indiana.

Mr. Richards cited a 1984 letter from Governor Orr concerning Indiana's position on unitary tax policy. (Exhibit 3) Mr. Richards highlighted some of the main issues and examples of the use of PICs for the Committee. He noted that it was a corporation's fiduciary right and responsibility to reduce its tax liability for its shareholders.

The Committee then discussed the following issues with Mr. Richards:

- cases involving an acknowledged presence by a PIC
- the complexity of possible legislation in this area
- file drawer corporations
- discrimination against related companies engaged in the similar transactions as unrelated companies

-- the Legislature's duty to look at revenue sources versus accountant's duties to minimize tax liability

Rep. Day noted that the Committee is not considering a change the treatment of unitary businesses or the use of combined reporting.

IV. Public testimony

The Chairman recognized Mr. Shaw Friedman, attorney. Mr. Friedman previously addressed the Committee in its first meeting regarding the benefits of membership in the Multistate Tax Commission (MTC). He responded to the COST's criticisms of MTC's study on PIC's. He discussed MTC's view that their tax shelter analysis and impact study was accurate. Mr. Friedman said that MTC did not feel that there were any errors or misrepresentations in their data.

The Chairman then allowed Mr. Sherman from the Ohio Department of Taxation to address some of the issues raised regarding the Ohio's law and how they deal with PIC's. Mr. Sherman testified that transaction between related companies have historically been treated differently than transaction between unrelated companies based on GAO and SEC standards. He also noted that the Ohio law has not been challenged in the courts over the last 14 years.

The Chairman then introduced Mr. Joe Dehaven, of the Community Bankers Association and Mr. Mark Schroeder, President of German American Bank Corporation in Jasper to testify.

Mr. Dehaven and Mr. Schroeder discussed the specific difficulties of including financial institutions in a law regulating PIC's. (Exhibit 4) They asked that special consideration be given to financial institutions due to the purely intangible nature of banks' assets. Mr. Schroeder also testified that any legislation should keep the playing field level for small to medium banks versus large national banks.

The Chairman then recognized Mr. Mark Cahoon of the Indiana Manufacturer's Association (IMA) to testify.

Mr. Cahoon asked that the Committee be sure that there is a problem with PIC's in Indiana before passing legislation and if there was legislation introduced it should only apply to royalties expenses. He also discussed the possibility of waiting for the Tax Court decisions on cases pending before drafting a proposal. Mr. Cahoon then discussed the concern from the IMA regarding the definition of legitimate business purpose.

Next, the Chairman introduced Mr. Grant Monahan, of the Indiana Retail Council, to testify.

Mr. Monahan expressed concerns about any legislation in this area, as well as discussing the fairness of this regulation.

The Chairman then recognized Mr. Jim Cousins of the Indiana Banker's Association to testify. Mr. Cousins reiterated the earlier testimony regarding fairness to small and medium banks in Indiana.

The Chairman introduced Mr. Mark St. John to speak on this issue. Mr. St. John spoke in support of regulating PIC's. He said he felt tax sheltering was unfair and shifted the tax burden to individuals.

V. Next meeting date and adjournment

The Chairman set the next meeting for September 29, 2004 at 10:00 A.M.

The meeting was adjourned at 12:27 P.M.